No. 451

In The

Supreme Court of the United States

October Term, 1944

The City National Bank and Trust Company, Trustee, Under Trust Agreement with Hamilton Depositors of Hamilton Trust Shares, Petitioner,

vs.

Commissioner of Internal Revenue.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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The City National Bank and Trust Company, Trustee, Under Trust Agreement with Hamilton Depositors of Hamilton Trust Shares, petitioner, respectfully prays for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Tenth Circuit entered May 13, 1944 (R., p. 290). Rehearing denied July 7, 1944 (R., p. 292).

JURISDICTION

The jurisdiction of the Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

(1) Whether a fixed investment trust is an association taxable as a corporation.

(2) Whether the determination of the Tax Court that the fixed investment trust here involved was not an association taxable as a corporation—a determination based on undisputed evidentiary facts of: Individual beneficial ownership as distinguished from group ownership of the underlying assets; impossibility of any common or group gain or loss; holding of the assets by the trustee for the preservation of the property and the collection of income for the owners; and lack of resemblance to corporate form; —whether its determination based on these evidentiary facts can be overturned because the Court of Appeals draws an opposite inference from the same evidence.

(3) Whether in a typical step transaction the determination of the Tax Court that the payment of dividends on the underlying stocks through the trustee to the beneficial owners of those stocks shall for tax purposes be treated as a single transaction, can be overturned because the Circuit Court on the same evidence deems the steps should be separated and a tax be levied on each.

(4) Whether the determination of the Tax Court that the trust is not a common enterprise for the transaction of business and sharing of gains but that the collection and distribution of income and other acts of the trustee are but incidental to the holding and conservation of the corpus, can be overturned by the Circuit Court because it draws a different inference from the same evidence.

(5) Whether if the trust is an association taxable as a corporation the dividends received on the underlying securities, being the sole income, can be taxable as net income, since the Circuit Court concedes that the very receipt of the dividends by the trustee creates a corresponding indebtedness to the beneficial owners of those underlying stocks.

(6) Whether there was substantial evidence to sustain the determination of the Tax Court.

STATEMENT

Petitioner is the trustee of the typical periodic payment fixed investment trust* here involved and has sole authority to protect the trust estate against unlawful tax claims (R., p. 128). Hamilton Depositors Corporation (hereinafter referred to as "Hamilton") is a kind of broker that sells its services to numerous small investors at a compensation specified in its agreement (certificate) with each of them. It selected a list of thirty of the leading stocks on the New York Stock Exchange and recommends the list as an investment (R., p. 105). It does not sell the stocks because it owns none, but it agrees with the investor that it will take his money, buy the stocks for him and deposit them with the trustee** (R., pp. 106, 107, 139), who will in turn pay him the dividends received thereon less its charges or reinvest them for him at his option in units of the same stocks (R., pp. 13, 114, 149, 150). A unit is one share of each of the thirty named stocks and 1/1000 of a unit is termed a "beneficial interest" (R., p. 12). The principal service rendered by Hamilton is that of enabling the small investor to purchase an undivided interest in the specified list of stocks and so diversify his investment, though he has not the money to purchase full shares of each stock (R., p. 141). The investor receives from Hamilton a "certificate" which is an agreement to invest whatever he pays in from time to time in those specified stocks (R., p. 106) and authorizes Hamilton to deduct its fees (R., pp. 110, 111). This is the only certificate the investor receives (R., p. 12). It does not specify how much he has

*There is no power of substitution (R., p. 16), but is power in Hamilton to eliminate any undesirable stock. None have ever been eliminated (R., p. 16). In case of elimination, reinvestment is limited to units of remaining stocks (R., p. 16).

**Certificate (R., p. 106)—"That the investor shall pay to the Corporation the sum of $.................. payable in the following manner: * * * That, pursuant to the terms * * * the said Corporation covenants and agrees to purchase with the funds applicable therefor from the payments received from the Investor * * * ."

invested or what interest he has or will have in the underlying securities purchased by the trustee. He has a bank book in which those items are entered in terms of "beneficial interests" from time to time as he makes payments for investment (R., p. 12). There is nothing in the record to sustain the court's statement that the certificates are listed on the Stock Exchange. They are not of the type that could be listed, nor are they negotiable (R., p. 19). Each investor buys an interest in the underlying stocks themselves—not in an entity which owns the underlying stocks.* When the money is paid in, usually in small installments, it is used with the money of other investors to purchase the specific stocks named** (R., p. 16), in which he immediately acquires an undivided interest (measured in beneficial interests) which is credited to him on the books of the trustee bank (R., p. 16). One investor has no relationship whatever to any other except that each employs Hamilton to perform these services for him and each owns an undivided interest in the stocks held by the trustee.

When these underlying stocks so purchased pay dividends to the trustee in whose name they stand, the trustee is obligated to credit quarterly each investor with his share thereof (R., pp. 13, 14), deductions therefrom being authorized only in the amounts agreed on by the investor in the certificate on account of services to him of Hamilton and the trustee. The very receipt of these dividends by the trustee creates under the contract the obligation to pay them to the individuals who own the undivided interests (R., p. 114). The Circuit Court itself so finds (R., p. 289). Neither the trustee nor Hamilton nor the group as a whole has any right to use this income as capital or for any purpose whatever. Each investor may withdraw his share of the securities or require its sale and the payment to him of the proceeds thereof (R., p. 20), or if he can find another person who is willing in writing to assume the obligations and payments specified in the certificate (R.,

*One share of each of the thirty named stocks.

**See Appendix, p. 32.

p. 19), he may sell and assign his entire certificate to that individual.*

The trustee holds the trust property in its vaults, collects the income thereon and distributes it according to the agreement to the owners of the individual interests—after deduction of fees. The income here sought to be taxed is all income so collected by the trustee for distribution to the individual beneficial owners thereof (Ex. 13, R., pp. 209, 229; Ex. 15, R., p. 253).

The Circuit Court of Appeals held that the trust resembles a corporation and that there is an association here taxable as a corporation and that all of the income of each of the individual investors derived from their individual share of the securities must be lumped into one sum on which the government will levy a corporate income and an excess profits tax.

In the entire history of the trust, since its commencement in 1931 to the date of trial, there have been purchased and deposited in trust with the trustee 2,859 shares of each of the thirty stocks named in the portfolio. (No others.) (85,770 shares in all.) *The only sale of stock ever made was a sale of six shares of each of the stocks (180 shares in all) in 1934 at the request of Harry Jackson, the owner of undivided interests equal to that many shares.* All the rest are still held by the trustee (R., p. 32). The entire proceeds of the sale went to Jackson (R., p. 17), no other investor realized or could realize a dime from the sale and financially it was wholly immaterial to each and all of them whether the stock sold at a high price or a low price, because it was Jackson's stock and not the stock of any entity, enterprise or group—just as is every other share of the underlying securities held in the trust.** The

*"The investors have never held a meeting of any kind and as a group have not had officers, directors, or a governing body, or used a minute book and seal. The investors received nothing to indicate the amount of their beneficial interest in the underlying securities, save the entry in the deposit record book." Findings of Tax Court (R., p. 19).

**(R., p. 36): "There is no profit to the corporation, the trustee, or the certificate holders as a group. * * * any profit from liquidations go to the investor who requests the liquidation. The distribution of dividends goes to each individual investor's account."

group and enterprise are unaffected and can suffer no loss and no gain by any sale. Jackson was entitled to all the proceeds. This was in exact compliance with the requirements of the agreement held by each investor. The Circuit Court found as a fact that the trust was an enterprise for the purchase and sale of stock—overruling the Tax Court's determination to the contrary.

STATUTE INVOLVED

The statute involved is as follows:

> Internal Revenue Code, Sec. 3797 (a) (3): "*Corporation.*—The term 'corporation' includes association, joint-stock companies, and insurance companies."

The tax provisions as to corporations are not in dispute.

RULING OF THE TAX COURT AND OF THE COURT BELOW

The Tax Court in a memorandum opinion entered on March 8, 1943, not reported but appearing in the Record (pp. 11-21) found for petitioner, holding that the trust here involved was not an association taxable as a corporation. It said (R., pp. 20, 21):

> "The present proceeding is so essentially similar to The Chase National Bank of the City of New York, as Trustee, 41 B. T. A. 430, affirmed (C. C. A., 2nd Cir.), 122 Fed. (2d) 540, that we have no difficulty in concluding that the result reached should normally be the same. *The Board there held that investment trusts of the fixed or non-discretionary type in which the managers 'were not given and did not * * * exercise any powers beyond those which are necessary incidents to the preservation of trust property, the collection of income therefrom, and its distribution to the holders of trust shares' are not associations taxable as corporations.* Not only is that a principle to which the Board has committed itself and in which it was there upheld on review but it has subsequently reaffirmed its position in an unpublished opinion and again been affirmed by a different circuit. Commissioner v. Buck-

ley (C. C. A., 9th Cir.), 128 Fed. (2d) 124. A District Court in still another circuit has arrived at the same conclusion. Equitable Trust Co. v. Magruder (U. S. D. C., D. of Md.), 37 Fed. Supp. 711.

"Such embarrassment as there is in the present proceeding arises from the circumstance that the single authority taking the opposite view is one which involves this petitioner, and which was handed down by the circuit to which the present proceeding will go for review. Hamilton Depositors Corp. v. Nicholas (C. C. A., 10th Cir.), 111 Fed. (2d) 385. *That case, however, is not conclusive by virtue of any principle of res judicata as is conceded, it being stated that counsel for the present parties 'both concluded that under the Supreme Court decision in the Nunnally case* (United States v. Nunnally Investment Co., 316 U. S. 258) *the point of res adjudicata couldn't be raised in this case.' Since, however, it is in our view impossible successfully to distinguish the Chase National Bank case, it thus appears inescapable that there is a conflict. Only resort to the Supreme Court or possibly to legislation can lay the matter finally at rest. It will not improve the situation for us to follow diametrically opposite views depending upon the circuit to which an appeal will lie.* And with the greatest deference to the court which decided the Hamilton Depositors Corporation case, the desirability of a shift of position on our part to conform with that result does not appear sufficiently imperative to justify the overturn of decisions of the Board which have now been affirmed in two circuits. *We feel constrained, therefore, to adhere to the position adopted in the Chase National Bank case and to disapprove the deficiency on the authority thereof.*" (Italics supplied.)

The Circuit Court of Appeals reversed the Tax Court (R., p. 282) 142 Fed. (2d) 771 (advance sheets). It held that the trust was a business trust, saying (R., p. 290):

"* * * The trust clearly was engaged in the business of buying and selling securities for income

and profit for its members. Its structure, while not identical to that of a corporation, was measurably akin thereto. Being an association in the nature of a corporation, it falls within the provisions of the act and is taxable accordingly."

The court further said (R., p. 289):

"* * * It is true that if the trustee receives income from the underlying securities, its receipt creates a corresponding indebtedness to the individual beneficiary and that the beneficial interest of the underlying securities was in the beneficiaries. But that is not decisive of the nature of the association. The legal title to the securities was in the trustee and the legal title to the income or profit in the first instance was likewise in the trustee. The moment when the legal title to the income passes to the beneficiaries is immaterial. The title must pass through the trustee. All the trustee ever has in the corpus of an estate or in the income therefrom is the naked legal title. The beneficial legal interest is always in the beneficiaries. This result flows from the very nature of a trust. The fact that one may have realized a gain and another a loss as a result of a sale of stock because they purchased on a different level does not change the nature of the association. It still is an association in which the beneficiaries join together for the common purpose of realizing profit and gain through the operation of the trust."

Petition for rehearing was filed on the 31st day of May, 1944, and denied on July 7, 1944.

REASONS FOR GRANTING WRIT

1. The Circuit Court of Appeals held that a fixed investment trust without power of substitution of securities is an association taxable as a corporation. This is in accord with the recent decision of the Third Circuit in *Pennsylvania Co. v. United States*, 138 Fed. (2d) 869 (decided November 16, 1943) and is contrary to the settled rule of the Tax Court and to decisions of the Second and Ninth

Circuits—*Commissioner v. Chase National Bank*, 122 Fed. (2d) 540 (C. C. A. 2), and *Commissioner v. Buckley*, 128 Fed. (2d) 124 (C. C. A. 9) decided May 8, 1943. The United States District Court for the District of Maryland in *Equitable Trust Co. v. Magruder*, 37 Fed. Supp. 711, holds with the Tax Court and with the Second and Ninth Circuits that it is not an association taxable as a corporation.

2. The Circuit Court held that though the beneficial ownership of the underlying securities rested in the individual beneficiaries in undivided interests and though the very receipt of the income by the trustee created a corresponding indebtedness to the individual beneficial owners, yet it must be taxed as a corporation as though the beneficial ownership was in the group rather than in the individual. This is in conflict with *Morrissey v. Commissioner*, 296 U. S. 344, which held that only where the trust property was to be used as capital for the transaction of business and the sharing of its gains was the trust taxable as a corporation. The Circuit Court failed to distinguish between the beneficial ownership of capital by an entity as in a corporation and beneficial ownership by the individual owners of undivided interests in the trust property which characterizes a trust. It is also in conflict with the settled principle of tax law as expounded by the Court of Appeals for the District of Columbia in *112 West 59th Street Corporation v. Helvering*, 68 Fed. (2d) 397, and *Central Life Assur. Soc. v. Commissioner*, 51 Fed. (2d) 939 (C. C. A. 8), which hold that only the beneficial owner is taxable.

3. The Circuit Court has overturned the fact determinations of the Tax Court that the trust was not given and did not exercise powers other than were necessary to the preservation of the trust property, the collection of income therefrom and its distribution to the owners thereof; that the trust was not a medium for the conduct of business and sharing its gains and was not an association taxable as a corporation. The Circuit Court has inferred from the evidence that it was engaged in the business of buying and selling stocks for profit. There was substantial evi-

dence to support the findings of the Tax Court and the Circuit Court is without power to substitute its judgment for that of the Tax Court. Its action is in conflict with *Dobson v. Commissioner*, 320 U. S. 489; *Commissioner v. Heininger*, 320 U. S. 467; *Wilmington Trust Co. v. Helvering*, 316 U. S. 164; *Colorado Nat. Bank of Denver v. Commissioner*, 305 U. S. 23; *Hulburd v. Commissioner*, 296 U. S. 300; *McCaughn v. Real Estate, Land Title & Trust Co.*, 297 U. S. 606; *Elmhurst Cemetery Co. of Joliet v. Commissioner*, 300 U. S. 37; *Neal v. Commissioner*, 53 Fed. (2d) 806 (C. C. A. 8); *Commissioner v. Sharp*, 91 Fed. (2d) 804 (C. C. A. 3)—which hold final the determination of the Tax Court in such matters.

4. The Circuit Court has held that the payment of dividends on the underlying securities to the beneficial owners thereof through a trustee must be separated into two taxable transactions, the dividends being taxed on payment to the trustee as though they beneficially belonged *en masse* to a group or association and again being taxed to the individual owners when received by them. This is contrary to the finding of the Tax Court which held, in effect, that the trustee was a mere conduit and that the transaction should be synthesized for tax purposes into a single one involving payment only by each individaul owner on his own share of the dividends. The Circuit Court was without power to substitute its judgment for that of the Tax Court in that matter under *Dobson v. Commissioner, supra*, which held that the power to determine whether transactions shall be synthesized or separated for tax purposes rests with the Tax Court and not with the regular courts.

5. The question involved as to the meaning of the statute in its application to investment trusts is one of great public importance.* If the Circuit Court of Appeals' decision is correct and the Supreme Court so finds, large

*The Securities & Exchange Commission in its 1940 report on "Fixed and Semi-Fixed Investment Trusts" states that 899 millions of dollars of securities had been sold under the fixed trust plan up to 1936—the peak of the fixed trust. University of Denver Business Review, June, 1930, lists all investment trusts as in excess of 3 billion dollars in value.

amounts of revenue otherwise unavailable, particularly in the Second and Ninth Circuits, will be collected by the government. If the Tax Court and the Second and Ninth Circuits are right and the Tenth and Third Circuits are wrong, then the government is wrongfully penalizing the many thousands of owners of interests in fixed investment trusts in the Tenth and Third Circuits.† Hundreds of millions of dollars have been invested by thousands of investors throughout the United States in various types of investment trusts. The courts are in a state of complete confusion as to the meaning of the *Morrissey* case, *supra,* in relation thereto. The sixteen judges of the Tax Court have consistently ruled as it did in this case without dissent. The District Court and two of the Circuit Court judges in the Second Circuit ruled with the Tax Court. The District Court and two of the Circuit Court judges in the Ninth Circuit ruled with the Tax Court. The District Court in Maryland ruled with the Tax Court. The District Court and three of the Circuit Court judges in the Third Circuit ruled against the Tax Court and the District Court and three of the Circuit Court judges in the Tenth Circuit ruled against the Tax Court. Yet, apparently no effort has ever been made by the government to obtain certiorari to have this matter finally determined by the United States Supreme Court—a fact forcibly commented on by the Ninth Circuit in *Commissioner v. Buckley, supra.**

Moreover, it is of great importance that the Tax Court and the Circuit Courts and the Treasury Department should be advised whether the Supreme Court is going to make effective its ruling in the *Dobson* case, *supra,* as to the finality of the Tax Court's findings or is going to recede therefrom. The Circuit Court in this case has over our earnest protest ignored that decision.

The ruling here and the Treasury regulation** asserting the taxability as corporations of all investment trusts—

†The little investment trust here involved has 7,500 investors.

*(p. 125): "*The Commissioner did not seek certiorari in the Chase Nat. Bank case although he claims the decision was wrong.* His funda-

(Continued on Bottom of Page 12)

fixed and management alike—regardless of beneficial ownership of the trust property—stand in flat contradiction to the most elementary principles of tax law, to the settled rule of the Tax Court and to the Circuit Court decisions above referred to. This creates a situation detrimental to the fair administration of the tax laws and adds measurably to the already existing confusion. It ought to be resolved in the interest of the public and the Treasury alike.

CONCLUSION

For these reasons it is respectfully submitted that the petition should be granted.

Respectfully submitted,

THE CITY NATIONAL BANK AND TRUST COMPANY, TRUSTEE, UNDER TRUST AGREEMENT WITH HAMILTON DEPOSITORS OF HAMILTON TRUST SHARES.

By MORRISON SHAFROTH,

Attorney for Petitioner.

(Continued from Page 11)

mental thesis is that for tax purposes all investment trusts should be classified as corporations. If the Commissioner is correct in this, it would seem that the courts have been expending much useless labor on the subject." (Italics supplied.)

**Treasury Regulations 101, Art. 901-2. "*Association.*—The term 'association' is not used in the Act in any narrow or technical sense. * * * It includes a voluntary association, a joint-stock association or company, a 'business' trust, a 'Massachusetts' trust, a 'common law' trust, an 'investment' trust (whether of the fixed or the management type) * * * ."

IN THE

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OCTOBER TERM, 1944

No...................

THE CITY NATIONAL BANK AND TRUST COMPANY, TRUSTEE, UNDER TRUST AGREEMENT WITH HAMILTON DEPOSITORS OF HAMILTON TRUST SHARES, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I

THE OPINIONS BELOW

The opinion of the United States Circuit Court of Appeals for the Tenth Circuit in this case is reported in *City National Bank & Trust Co. v. Commissioner*, 142 Fed. (2d) 771. This decision is found in the Record at page 282. The memorandum opinion of the Board of Tax Appeals, not reported, entered October 18, 1941, is found at page 11 of the Record.

II

JURISDICTION

The jurisdiction of the court is invoked under Sec. 240 (a) of the Judicial Code as amended. The judgment of the

United States Circuit Court of Appeals was entered on May 13, 1944. Petition for rehearing was filed on May 31, 1944, and denied on July 7, 1944.

III

STATEMENT OF THE CASE

A statement of the case is contained in the petition for certiorari, p. 3.

IV

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In reversing the decision of the Tax Court and giving judgment for the Commissioner.

2. In holding that the fixed investment trust here involved resembled a corporation and was an association taxable as a corporation.

3. In holding the trust to be a medium for the conduct of business and sharing its gains.

4. In holding that the income here taxed was taxable to the trust though its very receipt by the trustee created a corresponding indebtedness to the individual beneficial owners of the securities from which the income was derived.

5. In exceeding its power by overturning the determination of the Tax Court in the foregoing matters, that determination being final under the law.

V

ARGUMENT

1. The Circuit Court is Without Power to Overturn the Fact Determination of the Tax Court.

The controversy between the Tax Court and the Second and Ninth Circuits on the one hand and the Third and Tenth Circuits on the other as to the status of the fixed investment trust for tax purposes revolves primarily around the question of fact as to whether in that particular

type of trust the plan provides a medium for the conduct of business and sharing its gains with the ownership of capital as in a corporation, or whether it affords a means of investment to the individual in which the trustee acts primarily as an agent for the individual collecting and distributing the income and holding and conserving the corpus.*

The Tax Court held in this case, and has consistently held, that the fixed investment plan did not provide a medium for the conduct of business and sharing of its gains. The courts are all agreed that this factual test laid down by the Supreme Court in the case of *Morrissey v. Commissioner*, 296 U. S. 344, 80 L. ed. 262, is decisive in each case. It has long been the rule of the Supreme Court that the determination of the Tax Court on questions of fact is final and conclusive on the regular courts if there is any evidence to support it. The importance of this rule to a proper administration of the tax laws is forcefully presented by Mr. Justice Jackson in the court's opinion in *Dobson v. Commissioner*, 320 U. S. 489, decided December 20, 1943, in which he points out that while the prior cases had consistently held that the power to weigh the evidence and draw the conclusions and inferences therefrom lay in the Tax Court, that heretofore the regular courts had failed to give to the doctrine the finality given to administrative determination in other fields. The court said (p. 501):

> " * * * However, all that we have said of the finality of administrative determination in other fields

*In the Report of the Securities & Exchange Commission on "Fixed and Semi-Fixed Investment Trusts" in 1940, the Commission says (p. 8): "Management investment companies are generally corporate in form with legal title to all assets vested in the corporation. The investor in that type of investment company is a stockholder and as in other corporations has only an undivided participating right in the earnings and profits of the corporation and a proportionate participating rights in the property of the corporation on its liquidation.

"In the fixed trust on the other hand, the legal title to or the ownership of the trust property is vested in a trustee, usually a bank or trust company, which derives its power from a trust agreement between itself and the depositor and the owners of the trust certificates. The investor, like any other beneficiary of a trust, or cestui que trust, has a beneficial undivided interest in specific deposited securities or property."

is applicable to determinations of the Tax Court. Its decisions, of course, must have 'warrant in the record' and a reasonable basis in the law. But 'the judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body.' * * *

"Congress has invested the Tax Court with primary authority for redetermining deficiencies, which constitutes the greater part of tax litigation. This requires it to consider both law and facts. Whatever latitude exists in resolving questions such as those of proper accounting, *treating a series of transactions as one for tax purposes, or treating apparently separate ones as single in their tax consequences,* exists in the Tax Court and not in the regular courts; *when the court cannot separate the elements of a decision so as to identify a clear-cut mistake of law, the decisions of the Tax Court must stand.*" (Italics supplied.)

Again, on the same day in *Commissioner v. Heininger,* 320 U. S. 467, the court re-emphasized its determination to make final the decisions of the Board of Tax Appeals, saying (p. 475):

> " * * * *Except where a question of law is unmistakably involved* a decision of the Board of Tax Appeals on these issues, having taken into account the presumption supporting the Commissioner's ruling, should not be reversed by the federal appellate courts."

In *Wilmington Trust Co. v. Helvering,* 316 U. S. 164, Mr. Justice Douglas, speaking for the court, said (p. 168):

> " * * * It is the function of the Board, not the Circuit Court of Appeals, to weigh the evidence, to draw inferences from the facts, and to choose between conflicting inferences. The court may not substitute its view of the facts for that of the Board. Where the findings of the Board are supported by substantial evidence they are conclusive."

Clearly, the determination of the Tax Court in this case that the investment trust plan here creates no medium for the conduct of business and the sharing of its gains and that therefore it is not an association taxable as a corporation, is a determination of an ultimate question of fact.

The divergence among the Circuits arises from the different inferences drawn from the facts in the investment trust cases and from a lack of understanding of the fundamental difference between the common form of fixed and management trusts. There is no difference of opinion as to the law if the facts are as the Tax Court found them. The multitude of tax controversies which will arise with the ever-mounting tax burden may well overwhelm the regular courts unless factual determinations such as these are left to the expert opinion of the administrative tribunal equipped to handle the thousands of tax cases that annually come before it.

The finding of the Tax Court in this case that the trust is not an association taxable as a corporation carries with it the implication that it is a mere conduit through which the income from the underlying securities flows to the owners thereof. This is confirmed by the Circuit Court's own statement in its opinion (R., p. 289):

> "* * * It is true that if the trustee receives income from the underlying securities, its receipt creates a corresponding indebtedness to the individual beneficiary and that the beneficial interest of the underlying securities was in the beneficiaries."

On that state of facts the question as to whether the income on these underlying securities (which is the sole income involved in this proceeding) should be burdened twice—once with corporation taxes when received by the trustee and again with individual taxes when passed on to the beneficiaries—is a determination that the Supreme Court in the *Dobson case, supra*, declared to be peculiarly within the province of the Tax Court.

> "* * * Whatever latitude exists in resolving questions such as those of proper accounting, treating

a series of transactions as one for tax purposes, or treating apparently separate ones as single in their tax consequences, exists in the Tax Court and not in the regular courts; * * *" (pp. 501, 502).

We submit that the Circuit Court of Appeals has exceeded its power in overturning the determination of the Tax Court in this case and that its decision in so doing is in conflict with the Supreme Court cases cited.

2. The Circuit Court Decision is in Conflict with Decisions of the Second and Ninth Circuits and with the Settled Rule of the Tax Court.

In *Chase National Bank v. Commissioner,* 41 B. T. A. 430, a trust quite similar to that involved here was passed on by the Board of Tax Appeals. The Board in its syllabus says:

> "Fixed investment trusts under which for the purpose of conserving the trust property, the trustee has ministerial functions of holding corpus and collecting and distributing income and sales proceeds and a 'Depositor' has limited power to direct sales so as to eliminate unsafe investments but has no power to direct reinvestment, *held* not taxable as associations."

The opinion of the Board there is declared by it to be applicable to the trust here involved. It says in the *Chase case* (p. 442):

> "The plan clearly provides no 'medium for the conduct of a business and sharing its gains,' and the trustee's operations under them can not properly be called 'an enterprise for the transaction of business,' which the Supreme Court in *Morrissey v. Commissioner,* 296 U. S. 344, regarded as implicit in the statutory term 'association.' *The collection and distribution of income, the sales of securities and other acts of the trustee, and the acts of the depositor are but incidental to the holding and conservation of the corpus.* * * * " (Italics supplied.)

The Circuit Court of Appeals, in upholding the Board

in the *Chase Bank* case, *Commissioner v. Chase National Bank,* 122 Fed. (2d) 540, said (p. 543):

> "* * * What they were when created is determinable from the trust agreements and the application of the principles set forth in Morrissey v. Commissioner, 296 U. S. 344, 56 S. Ct. 289, 80 L. Ed. 263, leads to the conclusion, in support of the Board's decision, *that the trust property was to be held for investment and not to be used as capital in the transaction of business for profit like a corporation organized for such a purpose. This distinction is what makes the difference taxwise.* Sears, Trustee, v. Hassett, 1 Cir., 111 F. 2d 961." (Italics supplied.)

The principles above enunciated are, we submit, decisive of the controversy here.

In *Buckley v. Commissioner,* the Board of Tax Appeals, in a memorandum decision entered March 3, 1941, being Decision 11,696 C, opinion by Judge Opper, reaffirmed its ruling in the *Chase Bank* case, *supra.*

In affirming that opinion, the Circuit Court of Appeals for the 9th Circuit, *Commissioner of Internal Revenue v. Buckley,* 128 Fed. (2d) 124, said (p. 125):

> "We are told that the Securities and Exchange Commission has classified this entity as an investment trust of the fixed, open-end variety."* "It belongs in the same category as the investment trust involved in Commissioner v. Chase Nat. Bank, 2 Cir., 122 F. (2d) 540, 543. The court there thought that '*the trust property was to be held for investment and not to be used as capital in the transaction of business for profit like a corporation organized for such a purpose.*' * * *

It has similarly classified the trust in the pending case (Findings of Fact, R., pp. 17, 18): "In view of the fact that the portfolio is a fixed portfolio, requiring apparently little or no management or supervision, it appears that reference to a 'management fee,' without some qualification, has the capacity to mislead." Again, referring to the duties of the trustee or custodian, the Securities and Exchange Commission held (R., p. 18): " * * we believe the statement should be clarified so as to indicate that the duties of the custodian which are prescribed in detail by the trust agreement are solely ministerial and custodial in nature."

"The commissioner did not seek certiorari in the Chase Nat. Bank case although he claims the decision was wrong. His fundamental thesis is that for tax purposes all investment trusts should be classified as corporations. If the commissioner is correct in this, it would seem that the courts have been expending much useless labor on the subject." (Italics supplied.)

In *Equitable Trust Co. v. Magruder,* (D. Ct., Md., decided March 12, 1941) 37 Fed. Supp. 711, there was involved a capital stock tax on a fixed trust. The court's reasoning is unanswerable. It closely describes the arrangement here. Said the court (pp. 713, 714):

"It is important to note that the trustee has no power or discretion to deal with the amounts deposited by the holders of the certificates other than the purchase of the shares of stock of the Income Foundation Fund, Inc., after the deduction of the small percentages for expenses. * * * These are the essential features of the agreement although there are a large number of subordinate provisions which, in somewhat meticulous detail, define the respective obligations of the parties, and their exemptions from liability other than those expressly assumed. These details are not uncommon in agreements where a banking institution acts as trustee for a limited and particular purpose."

Continuing, the court said (pp. 715, 716):

"*As was said in the Morrissey case, an association implies associates, who must have a common interest in a common business enterprise.* It cannot be said that the several depositors in this case have any common association or interest in a common enterprise of which the Equitable Trust Company as Trustee is the managing agent. *The relationship of the trustee to the depositors is several and not joint, and there are no relations whatever of the several depositors inter sese. In this respect, they have nothing in common more than the individual depositors in any bank.* * * * *Under the agreement there is no relationship or obli-*

gation running from the trustee to the depositors as a group, but only to each of them separately under their respective certificates. The amounts of the several deposits with the trustee are not pooled in a common fund for joint benefit but are held and invested for the depositors severally and without regard one to another. * * *

"Nor can it properly be said that the Equitable Trust Company is the manager of a business trust or business enterprise, such as existed in the Morrissey case and the three cases following it. Not only is the obligation of the trustee several and not joint with respect to the depositors, but *the powers and duties of the trustee are strictly prescribed and limited with respect to the funds deposited by each depositor.* Indeed, it may be properly said that the duties of the trustee are purely ministerial. It must apply the balance of the deposit, over and above the deducted expenses, to one and only one purpose—the purchase at current market price of shares of stock of Income Foundation Fund, Inc.; and upon surrender of the certificate which evidences the trust, the sole duty of the trustee is to sell the applicable shares of stock at the current market price and pay over the net proceeds to the beneficiary. Likewise, as to the dividends received on account of the stockholdings, the trustee is required to reinvest them in the purchase of further shares of the same stock or, at the option of the beneficiary, pay them over to him." (Italics supplied.)

All of this is true of the Hamilton Trust.

The Sixth Circuit strongly leans to the position taken by the Tax Court and the Second and Ninth Circuits.

In *Cleveland Trust Co. v. Commissioner,* (CCA 6) 115 Fed. (2d) 481, the court said (pp. 483, 484):

"As we view the facts here, one of the essential attributes of a taxable association growing out of a trust is absent, i.e., that of holding and operating property by a trustee for profit. * * *

" * * The trust instrument shows no plan to carry on a business in buying, selling, leasing or dealing in real estate."

Again, in *United States v. Davidson*, (CCA 6) 115 Fed. (2d) 799, the court held the *sina qua non* of taxability was the presence of a joint enterprise.

Again in *Commissioner of Internal Revenue v. Gibbs-Preyer Trusts Nos. 1 and 2*, 117 Fed. (2d) 619, the Circuit Court of Appeals for the Sixth Circuit emphasizes that the capital supplied by the investors must be used in a joint enterprise involving the sharing of gains if the trust is to be held to be taxable as an association.

The recent decision of the Third Circuit in *Pennsylvania Co. v. Commissioner*, 138 Fed. (2d) 869, decided November 16, 1943, is flatly contrary to the *Chase National Bank* case, *supra*, to the *Buckley* case, *supra*, and to the decision of the Tax Court in this case. It completely overlooks the fundamental tests that are conclusive of this case and should have been conclusive of that. Without even mentioning it or apparently seeing it, it, as does the Tenth Circuit, leaps the gap between individual ownership and group ownership, holding that because the trust supplies a service to the individual which enables him individually to invest or speculate in undivided interests in the underlying securities, therefore the gain and income from each individual investment must be lumped for tax purposes so that the government can collect an income tax and an excess profits tax on the lump as though it actually beneficially belonged to an entity or association similar to a corporation. Of course, a brokerage house renders this very service for full shares of stock, but it has not yet been suggested that the income of all of its customers is taxable to the brokerage house. For an amazing statement of that proposition, see the two paragraphs at the close of the opinion preceding its discussion of the *Magruder* case, *supra*.

3. The Ruling of the Circuit Court is in Conflict with Morrissey v. Commissioner, 296 U. S. 344.

The leading Supreme Court discussion of the concept of a trust as a taxable entity is found in *Morrissey v. Commissioner, supra.* In that case the organizers of the "Western Avenue Golf Club" by declaration of trust conveyed property to the trustees and authorized the trustees to receive the rents, profits and income from the operation of the club and generally to manage the trust estate "as if the trustees were its absolute owners." Shares were issued to the organizers, "*a shareholder's interest being to receive dividends as declared.*" Please note—"*a shareholder's interest being to receive dividends as declared.*" (*Morrissey v. Commissioner,* 74 Fed. (2d) 803.) The principal contention of the taxpayer was that the proper test to be applied was whether the trustees act or carry on their business after the form and manner of a corporation in which the beneficiaries have a voice in the management and an opportunity to exercise such control through the right to vote at meetings. The Supreme Court held (pp. 357, 358):

> "The inclusion of association with corporations implies resemblance; but it is resemblance and not identity. * * * the absence of particular forms, or the usual terminology of corporations, cannot be regarded as decisive."

> p. 359) "What, then, are the salient features of a trust—*when created and maintained as a medium for the carrying on of a business enterprise and sharing its gains*—which may be regarded as making it analogous to a corporate organization?" (Italics supplied.)

The Supreme Court then recites the *five secondary tests* relied on by the Circuit Court: (1) A continuing entity throughout the trust period. (2) Centralized management. (3) Continuity of the trust, uninterrupted by death, among the beneficial owners. (4) Means for transfer of beneficial interests. (5) Limitation of personal liability of participants to property embarked in the undertaking.

The Supreme Court continues (pp. 359, 360):

"It is no answer to say that these advantages flow from the very nature of trusts * * *. *The suggestion ignores the postulate that we are considering those trusts which have the distinctive feature of being created to enable the participants to carry on a business and divide the gains which accrue from their common undertaking,—trusts that thus satisfy the primary conception of association and* have the attributes to which we have referred, distinguishing them from partnerships. *In such case,* we think that these attributes make the trust sufficiently analogous to corporate organization to justify the conclusion that Congress intended that *the income of the enterprise* should be taxed in the same manner as that of corporations." (Italics supplied.)

Moreover, at p. 356, the court says:

"'Association' implies associates. It implies the entering into a joint enterprise, and as the applicable regulation imports, an enterprise for the transaction of business."

Then referring to the beneficiaries of an ordinary trust (p. 357):

"* * * Such beneficiaries do not ordinarily, and as mere cestuis que trust, *plan a common effort or enter into a combination for the conduct of a business enterprise.* * * * But the nature and purpose of the *cooperative undertaking* will differentiate it from an ordinary trust. *In what are aclled 'business trusts' the object is not to hold and conserve particular property with incidental powers,* as in the traditional type of trusts, but to provide a medium for *the conduct of a business and sharing its gains.*" (Italics supplied.)

The Circuit Court stresses the secondary tests and disregards the foundation—the primary test—on which they must rest in order to have any significance in characterizing

a trust as an association taxable as a corporation. Those primary, fundamental requirements stressed again and again by the court rest on a *combination of beneficiaries in a common business enterprise,* the "gains from the *common undertaking*" to be divided. There must be possible "*income from the enterprise.*" Moreover, there must be a resemblance between the trust sought to be taxed and a corporation.

As appears from the facts hereinbefore set forth, there is no resemblance whatever in this case to corporate form. The certificate has not the slightest resemblance either in form or fundamental character to the stock certificate of a corporation. It merely requires Hamilton to buy with the investor's money securities in which the investor retains an undivided interest—not an interest in any group or entity.

The only sale ever made in the entire history of the trust was at the request of one Harry Jackson who owned beneficial undivided interests equal to eight shares of each of the underlying stocks. When this stock was sold he received all of the proceeds. The net assets of the group or enterprise and each of the remaining individuals were precisely the same the moment before and the moment after the sale whether the price received was high or low. Suppose each and every investor—as Jackson did—had his interest in the underlying stocks liquidated at the same time. Every investor has a different cost for his part of the underlying stocks. One gains, another loses. But the group as a whole neither gains nor loses. Suppose the market is such that on the date of this sale had the stocks belonged to a group or association there would have been a profit to it—in other words, suppose the total price received was greater than the total price paid for these underlying stocks—then if the enterprise is joint and if it is an association resembling a corporation, this gain would have to be divided pro rata—when and if distributed—to all of the stockholders or members of the association. This is of

the very essence of a common or corporate enterprise. Of course, if the enterprise is common, everyone shares the gain. But Jackson bought his share of these stocks when the price was low and Jones bought his share when the price was high. Jackson has a gain. Jones has a loss. The trustee certainly couldn't give Jones and the other losers a part of Jackson's profit. There can't be the slightest doubt under the trust agreement as to Jackson's rights. It is self-evident that the purchase and sale of any of the stocks is the speculation of the individual owner and not of a group or association—or of a trust which merely for a price furnishes services which assist the individual investor in carrying on his operation.

The enterprise cannot be common or joint or similar to a corporation when it is impossible on a sale of the underlying assets to have a common gain divisible pro rata among the members and when it is a matter of complete financial indifference to the group as a whole and to everyone save the individual whose interest in the underlying stocks is sold, whether the price is at the peak or at the bottom of the market.

The ownership of the trust assets by individuals rather than by the group with the right to withdraw their share at will and the right of each individual to his share of the dividends on those underlying securities, rebuts any claim of corporate resemblance in the trust.

3(a). Ownership by Investors of the Underlying Assets Negates All Possibility of Corporate Resemblance.

Said Mr. Justice Holmes in *Klein v. Board of Tax Supervisors,* 282 U. S. 19, 24, 75 L. ed. 140, 143:

> "But it leads nowhere to call a corporation a fiction. If it is a fiction, it is a fiction created by law with intent that it should be acted on as if true. *The corporation is a person, and its ownership is a non-conductor that makes it impossible to attribute an interest in its property to its members.* Donnell v. Herring-Hall-Marvin Safe Co., 208 U. S. 267, 273, 52 L. ed. 481,

487, 28 S. Ct. 288. The stockholders in some circumstances can call on the corporation to account, but that is a very different thing from having an interest in the property by means of which the corporation is enabled to settle the account." (Italics supplied.)

Over and over again has this principle been reiterated by the courts.

In *Eisner v. Macomber,* 252 U. S. 189, 64 L. ed. 521, the Supreme Court has in clear and convincing language delineated the fundamental nature of a corporation. Unless "opposites" are "likes" it leaves no room for a finding of corporate resemblance in the trust in this case where the beneficial ownership of the assets is in the individual investor in undivided interests. Said the court (pp. 529, 531, 532):

> "Certainly the interest of the stockholder is a capital interest, and his certificates of stock are but the evidence of it. They state the number of shares to which he is entitled and indicate their par value and how the stock may be transferred. They show that he or his assignors, immediate or remote, have contributed capital to the enterprise, that he is entitled to a corresponding interest proportionate to the whole,—entitled to have the property and business of the company devoted during the corporate existence to attainment of the common objects, — entitled to vote at stockholders' meetings, to receive dividends out of the corporation's profits if and when declared, and, in the event of liquidation, to receive a proportionate share of the net assets, if any, remaining after paying creditors. *Short of liquidation, or until dividend declared, he has no right to withdraw any part of either capital or profits from the common enterprise; on the contrary, his interest pertains not to any part, divisible or indivisible, but to the entire assets, business, and affairs of the company. Nor is it the interest of an owner in the assets themselves, since the corporation has full*

title, legal and equitable, to the whole. The stockholder has the right to have the assets employed in the enterprise, with the incidental rights mentioned; *but, as stockholder, he has no right to withdraw, only the right to persist, subject to the risks of the enterprise,* and looking only to dividends for his return. If he desires to dissociate himself from the company, he can do so only by disposing of his stock.

"* * * *None of these, however, gives the stockholders as a body, much less to any one of them, either a claim against the going concern for any particular sum of money or a right to any particular portion of the assets or any share in them unless or until the directors conclude that dividends shall be made and a part of the company's assets segregated from the common fund for the purpose.* * * * " (Italics supplied.)

3(b). The ~~Tax~~ Circuit Court Ruling that Though the Receipt of the Income Creates a Corresponding Indebtedness to the Individual Beneficiary Yet the Income is Taxable to the Trust, Is in Conflict with Decisions of the Court of Appeals for the District of Columbia, the Eighth Circuit and Settled Principles of Tax Law.

The settled principle of tax law that income can only be taxed to its *beneficial* owner is laid down in Mertens "Law of Federal Income Taxation" (1942) vol. 2, p. 599, where the author says:

"* * * Where the recipient of income is serving merely as a conduit or transmitter of such income, he is not liable for tax on such income. The purpose of the income tax laws is to tax income to the person who has the right or beneficial interest therein and not to throw the burden on a mere conduit, collector or innocent agent. The tax is laid only on what is received for one's own benefit."

In *Central Life Assur. Soc. v. Commissioner,* 51 Fed. (2d) 939, Judge Stone speaking for the Eighth Circuit said (p. 941):

"Tax laws are essentially practical in their purposes and application, and the federal income tax laws are no exception. While, for purposes of convenience and certainty in collection of such taxes, it is sometimes provided that those who collect income for others shall pay therefrom the taxes thereon, yet a cardinal purpose of the income tax laws is to tax the income to the person who has the right or beneficial interest therein, and not to throw the burden upon a mere collector or conduit through whom or which the income passes."

In *112 West 59th Street Corporation v. Helvering*, 68 Fed. (2d) 397, Mr. Justice Groner speaking for the Court of Appeals for the District of Columbia, after quoting the above statement of Judge Stone, adds (p. 398):

"We think this a correct statement of the law. If, therefore, it appears as we think it does appear, that petitioner was a mere 'conduit,' and that it never at any time had any legal right to retain the profits from the transaction in question and never at any time had possession of such profits, but that on the contrary the profits in right and in law were always the property of the trust, then it would seem to follow that the liability to pay the tax under the federal income tax laws was solely a liability of the trust and not a liability of petitioner."

The principle would seem self-evident that when an individual, corporation, or association receives money, the receipt of which automatically creates an equal and corresponding debt, it can have no net income therefrom. It is no better off after receiving a million dollars of such money than if it only received a thousand dollars or none at all.

In the pending case the investor's right under his contract is that of either a direct ownership in the money received from the underlying securities or a right arising on the receipt of the money by the trustee to be paid a corresponding amount, creating a direct debt on the part of the

trustee to pay it to him.* The books necessarily show at the end of the year under such an arrangement receipts of $111,116.81, as in one of the years here involved, and a corresponding indebtedness of $111,116.81 to the individual investors arising from the very receipt thereof. Each of the individual investors has income which he reports, but clearly the trust has none. The accountability of the trustee to the individual and not to a group is clear under the contract here involved and is admitted by the Circuit Court of Appeals.

*"The International Trust Company holds all the trust securities in its Trust Department, and all cash balances in its commercial banking department, as a debtor therefor" (R., p. 164).

VI

CONCLUSION

We submit that if the trust in this case is taxable as a corporation, then every fixed investment trust in the United States is so taxable. The hairline distinctions attempted to be drawn in some of the cases merely multiply the confusion that exists as to the governing principles. If all fixed investment trusts are to be taxed as associations, then the Treasury is entitled to know it and the government is entitled to collect the tax thereon all over the United States and not simply in the isolated circuits which at the present time so hold. If they are not so taxable, then the taxpayers who are being wrongfully penalized in the Tenth Circuit and in the Third Circuit are entitled to be relieved of this unfair and unjust burden. Moreover, if the Tax Court really has the authority that the *Dobson* case, *supra,* gives it, it will lead to a more orderly and fair administration of the tax law if that decision is made effective.

For the foregoing reasons it is submitted that a writ of certiorari should issue to the Circuit Court of Appeals for the Tenth Circuit.

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APPENDIX

(R., pp. 106, 107) Certificate:

" * * * the said Corporation covenants and agrees to purchase with the funds applicable therefor from the payments received from the Investor and with accumulations as hereinafter and in said Trust Agreement provided, an equal number of shares of each of the stocks of the corporations hereinafter named, at the market prices of such securities at date of purchase, and further covenants and agrees to deposit all securities so purchased in trust with the Trustee for the benefit of the holders of this and all other similar Certificates outstanding, *the Investor's interest depending upon the amount of his credits* used in each purchase of securities, and the method of determining which is fully set forth in said Trust Agreement." (Italics supplied.)

(R., pp. 108, 109):

" * * * The Investor may, from time to time, pay to the Corporation, * * * amounts in addition * * * and any such payments less the hereinafter described deductions, will be transmitted to the Trustee for the benefit of the Investor * * * and will tend to accelerate * * * from time to time *the Investor's proportionate interest in the trust property* to the extent hereinbefore provided." (Italics supplied.)

(R., p. 109):

" * * * whereupon the Corporation *shall dispose of the Investor's interest in the trust securities as shown by the books of the Corporation,* or such part thereof as the Investor desires to liquidate, * * *. * * * The sum derived from such sale (plus the Investor's share of the uninvested cash balance as shown by the books of the Corporation, without interest thereon) but less brokerage costs of selling and taxes, if any, levied against the same shall be paid to the

Investor within five (5) days after receipt of such notice or as soon thereafter as may be practicable."

(R., p. 122):

"15. As soon as and as often as units of the securities in the portfolio have been purchased such commitment will be split up and divided into beneficial interests by the Corporation and charged to the account of the respective Investors by the Corporation in substantially the following manner, to-wit:"

(R., p. 135):

In case Hamilton decides to offer a new portfolio to Investors "Any Investor shall have the option of turning in his old Certificate to the Corporation for cancellation and of having the Corporation transfer *the credit representing his interest in the trust property,* as shown by the books of the Corporation, to the newly submitted Certificate based upon the new portfolio, * * * ."

(R., p. 139):

" * * * *The investor's payments,* after deduction of charges, *are invested* at the direction of the Hamilton Depositors Corporation by the International Trust Company *in the common stocks of the thirty companies comprising the Trust.* The Trust Fund is divided into Beneficial Interests which are allocated to each investor's account in proportion to the funds which he has contributed."

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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 451

THE CITY NATIONAL BANK & TRUST COMPANY, TRUSTEE, UNDER TRUST AGREEMENT WITH HAMILTON DEPOSITORS OF HAMILTON TRUST SHARES, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 11) is not officially reported. The opinion of the Circuit Court of Appeals for the Tenth Circuit (R. 282) is reported in 142 F. 2d 771.

JURISDICTION

The judgment of the circuit court of appeals was entered on May 13, 1944 (R. 290), and petition for rehearing was denied on July 7, 1944 (R. 292). Petition for a writ of certiorari was filed on September 9, 1944. Jurisdiction of this Court is invoked under Section 240 (a) of the

Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the circuit court of appeals properly found that the investment trust involved herein is an association taxable as a corporation within the meaning of Section 901 (a) of the Revenue Act of 1938 and the identical language of Section 3797 (a) (3) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra*, pp. 14–19.

STATEMENT

The Commissioner of Internal Revenue found a deficiency in the income and excess-profits tax liability of petitioner's predecessor for the year ended April 30, 1939, and in its income tax liability for the year ended April 30, 1940 (R. 6–7). The case was submitted to the Tax Court on an agreed statement of facts (R. 52–56) incorporating a number of exhibits (R. 56–273), all of which facts were found by the Tax Court (R. 11). In addition, testimony was taken (R. 22–51) "to explain a little more fully the operation" of the trust (R. 24).

The Hamilton Trust, herein called the trust, was created by a written declaration of trust dated July 23, 1931, executed by Hamilton Depositors Corporation, herein called the corpora-

tion, the Guardian Trust Company of Denver, Colorado, and such persons as might from time to time purchase trust share certificates, herein called beneficiaries or investors (R. 12, 104). The International Trust Company of Denver, Colorado, herein called trustee, was substituted as successor trustee on March 10, 1934 (R. 3), but while this proceeding was pending in the Tax Court, The City National Bank and Trust Company of Kansas City, Missouri succeeded International as trustee on May 31, 1941 (R. 11), and was by order of the Tax Court substituted as petitioner (R. 10–11).

"The purpose of the Hamilton Plan", according to its prospectus, is to provide a method of purchasing through common stocks, an ownership interest in a diversified and carefully selected group of thirty leading American corporations" (R. 141). The agreement underlying this investment trust provides that the trustee, at the direction of the corporation, is to use monies supplied by the investors to pay for specified stocks, purchased by the corporation for the trustee (R. 106), and comprising the portfolio of the trust (R. 13, 195). Units purchased by the corporation are composed of an equal number of common shares of each of the companies named in the agreement (R. 108). A person may become an investor by application to the corporation accompanied by his first payment for an interest in the securities. The corporation then issues

a trust share certificate to the investor after it has been authenticated and recorded on the books of the trustee. (R. 12.) The payments received by the corporation, less its commissions, are deposited with the trustee's bank to the credit of the trustee (R. 13, 108).

The trust agreement contemplates that the stocks will be sold from time to time and the proceeds reinvested (R. 104, par. 1; R. 121, par. 13; R. 123–124, pars. 18–21). Although the agreement provides that there shall be "no right of substitution" of stock in the portfolio (R. 123, par. 18), paragraph 64 (R. 135) provides in part that:

> At any time that the Corporation shall decide that the portfolio then in effect is no longer in proper balance on account of changing conditions and/or eliminations, stock dividends and split-ups, it shall have the right to prepare a new portfolio and to offer to the Investors, individually and not collectively, a new Certificate based thereon. * * *

The trustee holds title to all funds (R. 126, par. 28), accounts to the corporation (R. 127, par. 34), and purchases additional units with the accumulated funds (R. 124, pars. 20–21). In its individual capacity, the trustee may contract with the corporation and any of the companies whose stock it holds either with relation to trust shares or otherwise (R. 128, par. 37); it has power to take any action deemed advisable in connection with the execution of the trust (R. 128, par. 39),

and the trustee may employ agents and attorneys in the execution of its duties under the trust (R. 129, par. 42). No individual liability attaches to the trustee (R. 114; R. 128, pars. 40–41; R. 129, pars. 45–46).

The income and profit from the operation of the trust are distributed and paid to the beneficiaries according to the number of units they hold or, in other words, the interest they have in the trust (R. 109, 111–112, 114–115). The beneficiaries or investors ordinarily have no voice in the management or operation of the trust (R. 19), and the only time that beneficiaries have a voice in the affairs of the trust is if and when the trust ceases to do business or to perform its functions (R. 132–134, par. 55 (a)). The voting power of the stocks is vested in the corporation (R. 122, par. 16). No personal liability attaches to the beneficiaries (R. 107, 114), and the right is afforded them to transfer, sell, and assign trust certificates or shares of the trust (R. 110).

The business done by the Hamilton Trust from its inception in 1931 as well as during the tax years in question has been very extensive. In the approximately eight years from its institution to August 31, 1939, $4,428,561 has been paid in on the issued certificates (R. 155) which have a face value of $14,986,667 (R. 155), and there has been purchased and deposited with the trustee a total of 85,770 shares of stock (2,859 shares of each of 30 stocks named in the portfolio) (R. 17). On

August 7, 1939, the market value of securities then held by the Hamilton Trust was $3,099,688 (R. 14–15). On April 30, 1939, 8,907 certificates were held by investors; on April 30, 1940, 9,350 certificates (R. 55, Stip. par. 17). During the fiscal years ending April 30, 1939, and April 30, 1940, sums were deposited to the credit of the trustee by the corporation aggregating respectively $712,676 and $630,143 (R. 14). These sums were used by the trustee to purchase stock and for the conversion of beneficial interests (R. 14).

The Tax Court concluded that the trust was not an association taxable as a corporation (R. 20–21). The basis of its decision (R. 20) was that the

> proceeding is so essentially similar to *The Chase National Bank of the City of New York, as Trustee,* 41 B. T. A. 430, affirmed (C. C. A., 2nd Cir.), 122 Fed. (2d) 540, that we have no difficulty in concluding that the result reached should normally be the same.

The court below reversed (R. 290) and adhered to its prior decision in *Hamilton Depositors Corp.* v. *Nicholas,* 111 F. 2d 385, rehearing denied May 22, 1940, involving the same question as to this Hamilton Trust which arose in connection with the capital stock tax for the years 1933 to 1936.

ARGUMENT

1. Although the precise question of whether an investment trust is an association taxable as a corporation has never been decided by this Court, the principles to be followed in determining the answer are clearly set forth in *Morrissey* v. *Commissioner,* 296 U. S. 344; *Swanson* v. *Commissioner,* 296 U. S. 362; *Helvering* v. *Combs,* 296 U. S. 365; *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369; and *Lewis & Co.* v. *Commissioner,* 301 U. S. 385. This Court denied the petition for a writ of certiorari in *Pennsylvania Co. for Insurances, etc.* v. *United States,* 138 F. 2d 869 (C. C. A. 3d), certiorari denied, 321 U. S. 788 (see Nos. 691 and 692, October Term, 1943), which presented many of the contentions raised here as to investment trusts. The decision below does not conflict with the principles established by this Court in the *Morrissey* case, *supra.* The trust was used by a large number of persons in association as a medium for conducting a business enterprise and for the sharing of its gains and not merely as a means of conserving property. The essential attributes of this trust closely resemble those of the corporate form. The management of this joint enterprise, acting in behalf of a large group of associated persons, is centralized; the entity is a continuing one and the period of trust perpetual (R. 167); the interests of the

participants, represented by certificates similar to shares of corporate stock, are transferable; the continuity of the trust is not affected by death among the beneficial owners; and the personal liability of participants is limited to property invested in the undertaking.

The record contains abundant evidence of the commercial character of this enterprise and establishes clearly its role as a profit-making medium, rather than as a traditional trust, primarily intended for the conservation of property. See, for example, "Exhibit 4, Prospectus, The Hamilton Investment Plan," filed with the Securities and Exchange Commission, effective date October 19, 1939. (R. 137–169.)

Petitioner's contention (Br. 26) that beneficial ownership of the underlying assets by the investors negates all possibility of corporate resemblance was fully answered by the court below (R. 289), which noted that the legal title to the securities is in the trustee as is the title to the income and profit in the first instance. As that court pointed out, thefact that when the trustee receives income from the underlying securities, its receipt creates a corresponding indebtedness to the individual beneficiary and that the beneficial interest is in the beneficiaries is not decisive of the nature of the enterprise. The fact that the investors have no power to vote the shares in the portfolio (R. 122, par. 16) is at least of equal significance as one instance of the manner

in which the trustee is more than a conduit. But what is decisive in this case is the use of this device as "a medium for the carrying on of a business enterprise by the trustees and participation in the profits by numerous beneficiaries whose interests were represented by transferrable share certificates, thus permitting the introduction of new participants without affecting the continuity of the plan." *Lewis & Co.* v. *Commissioner,* 301 U. S. 385, 388. No doubt has been expressed by courts dealing with investment trusts that that form of enterprise meets, in this particular, the "corporate form" test prescribed by the *Morrisey* case. There can, therefore, be no conflict between the lower court's ruling and *Central Life Assur. Soc., Mut.* v. *Commissioner,* 51 F. 2d 939 (C. C. A. 8th), and *112 West 59th Street Corp.* v. *Helvering,* 68 F. 2d 397 (App. D. C.), neither of which was concerned with investment trusts.

The petitioner also contends that the decision of the court below is in conflict with the decision of the Second Circuit Court of Appeals in *Commissioner* v. *Chase Nat. Bank,* 122 F. 2d 540, and with that of the Ninth Circuit in *Commissioner* v. *Buckley,* 128 F. 2d 124. Unless the basis of the asserted conflict is a contention that investment trusts, generally, are not taxable, a view which has been accepted by no court, we submit that the provisions of the trust agreement in this case differ substantially from those in the agreements in-

volved in the *Chase Nat. Bank* and *Buckley* cases. In neither case was the trustee or the corporation given the power, present here, to reinvest proceeds of stock eliminated under the plan. There was no broad and unlimited discretion such as the trust declaration here provides, empowering the corporation to eliminate securities. Actually the power of elimination and reinvestment in this case affords the corporation, acting in conjunction with the trustee, substantial powers of management by which the contents of the portfolio as a whole and the undivided interest of each investor may be radically altered (R. 123-124). In addition, the power of the corporation to propose a complete revamping of the portfolio when business conditions warrant (R. 135; par. 64), though not identical with the power to substitute securities present in *Commissioner* v. *North American B. Trust*, 122 F. 2d 545 (C. C. A. 2d), must lead to the same result. In that case, which was decided at the same time as the *Chase Nat. Bank* case, the Circuit Court of Appeals for the Second Circuit held that the trust was an association. We believe, therefore, that the court below properly held that there was no conflict.

As observed by this Court in the *Morrissey* case, *supra*, p. 356:

> * * * it is impossible in the nature of things to translate the statutory concept of "association" into a particularity of detail that would fix the status of every sort of

> enterprise or organization which ingenuity may create, * * *.

See, also, *Pennsylvania Co. for Insurances, etc.* v. *United States, supra.* We submit that the criteria propounded by this Court in the ***Morrissey*** case, ***supra,*** and elaborated by the Treasury Regulations (Appendix, ***infra,*** pp. 14–19) have been properly applied by the court below to the precise facts of this case.

2. The court below did not err in reviewing the decision of the Tax Court. The question in no way resembles that involved in *Dobson* v. ***Commissioner,*** 320 U. S. 489, rehearing denied, 321 U. S. 231. The facts are not in dispute and the decision of the Tax Court on the question of the classification of an entity as an association or a strict trust under the statute is a question of law which may be reviewed on appeal.[1] Cf. ***Security Mills Co.*** v. ***Commissioner,*** 321 U. S. 281. Compare ***Helvering*** v. ***Combs, supra,*** where this Court reversed a decision of the circuit court of appeals which had affirmed the holding of the Board of Tax Appeals that an enterprise was not an association.

That the ruling in this case is of the type that is reviewable is evident, for the Tax Court rested

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[1] Contrary to the petitioner's assertion (Pet. 10, 17–18), the question before the Tax Court and the circuit court of appeals was not the determination of whether a series of transactions should be treated separately or as one for tax purposes. The question whether a trust is an association involves no such problem.

its decision solely upon (R. 21) the belief that this case involved "a principle to which the Board has committed itself and in which it was there upheld on review" in *Chase National Bank* v. *Commissioner,* 41 B. T. A. 430, affirmed, 122 F. 2d 540 (C. C. A. 2d). The Tax Court pointed out further that it "subsequently reaffirmed its position in an unpublished opinion and [had] again been affirmed by a different circuit" in *Commissioner* v. *Buckley, supra.* Indeed, it appears clear that the Tax Court itself considered the final question as one of statutory construction subject to judicial review when "with the greatest deference" (R. 21) to the Tenth Circuit Court of Appeals, which had previously held this in-

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[2] *Hamilton Depositors Corp.* v. *Nicholas*, 111 F. 2d 385, rehearing denied May 22, 1940. The decision in this case would have been controlled under the principle of *res judicata*, by *Hamilton Depositors Corp.* v. *Nichols*, *supra*, except for the technicality that the action in the earlier case was brought against a Collector of Internal Revenue, whereas the Commissioner of Internal Revenue is respondent in this proceeding (R. 21). See *United States* v. *Nunnally Investment Co.*, 316 U. S. 258. The rule in the *Nunnally* case is no longer applicable (Internal Revenue Code, Section 3772 (d) (26 U. S. C. 3772), as amended by Section 503, Revenue Act of 1942, c. 619, 56 Stat. 798), and had the present proceeding, in fact, been instituted after June 15, 1942, instead of, as it was, on February 1, 1941 (R. 277), the principle of *res judicata* would have applied and the Tax Court would have been bound by the decision of the circuit court of appeals in the cited case.

vestment trust an association,[2] it refused to follow that decision, saying (R. 21):

> It will not improve the situation for us to follow diametrically opposite views depending upon the circuit to which an appeal will lie.

The problem in this case is not one of accounting, and, moreover, the ruling of the Tax Court cannot be reconciled with the Treasury Regulation provision (Art. 901-2, Appendix, *infra,* p. 15) that investment trusts are taxable as corporations. It was, therefore, "not in accordance with law" and is subject to review under the decision in the *Dobson* case, 320 U. S. at 492.

CONCLUSION

The decision of the court below is correct, and there is no conflict of decisions. The court below did not exceed its judicial authority in reviewing the decision of the Tax Court in this case. The petition for a writ of certiorari should be denied.

Respectfully submitted.

Charles Fahy,
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Samuel O. Clark, Jr.,
Assistant Attorney General.
Sewall Key,
Helen R. Carloss,
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Special Assistants to the Attorney General.

October 1944.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 901. DEFINITIONS.

(a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

* * * * *

(6) The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

* * * * *

(8) The term "stock" includes the share in an association, joint-stock company, or insurance company.

(9) The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

* * * * *

(b) The terms "includes" and "including" when used in a definition contained in this Act shall not be deemed to exclude other things otherwise within the meaning of the term defined.

Section 3797 (a) (1), (3), (6), (7), and (8) and (b) of the Internal Revenue Code is identical with Section 901 (a) (1), (2), (6), (8), and (9), and (b) of the Revenue Act of 1938.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 901-1. *Classification of taxables.*—For the purpose of taxation the Act makes its own classification and prescribes its own standards of classification. Local law

is of no importance in this connection. Thus a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See article 901-3.) The term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. (See article 901-4.) The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See articles 901-2 and 901-4.) The definitions, terms, and classifications, as set forth in section 901, shall have the same respective meaning and scope in these regulations.

ART. 901-2. *Association.*—The term "association" is not used in the Act in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsur-

ance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Act, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

ART. 901-3. *Association distinguished from trust.*—The term "trust," as used in the Act, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association

or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages. The nature and purpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not be considered narrower than that which is formally set forth in the instrument under which the activities of the trust are conducted.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Act as a corporation. However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation

of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form *itself*. The Act disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division

and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

Sections 19.3797–1, 19.3797–2 and 19.3797–3 of Treasury Regulations 103, promulgated under the Internal Revenue Code, are identical with the articles of Treasury Regulations 101 quoted above with the exception that references are made therein to the Internal Revenue Code instead of to the Revenue Act of 1938.

U. S. GOVERNMENT PRINTING OFFICE: 1944

No. 451

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

THE CITY NATIONAL BANK AND TRUST COMPANY, TRUSTEE, UNDER TRUST AGREEMENT WITH HAMILTON DEPOSITORS OF HAMILTON TRUST SHARES, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR REHEARING.

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PEERLESS PRINTING COMPANY, DENVER

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vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR REHEARING.

Petitioner prays for a rehearing on its petition for certiorari for the following reasons:

This case typifies administrative injustice and judicial confusion.

For years neither the Bureau of Internal Revenue nor the courts conceived the fixed investment trust to be within the orbit of the corporate tax.

For some time prior to the determination of this Court in *Morrissey v. Commissioner,* 296 U. S. 344, various business enterprises had sought to avoid the corporation tax by forms of organization essentially similar to the corporation in nature though not in form. Such was the Massachusetts Trust. The Treasury properly attacked these schemes and in the *Morrissey* case, *supra,* obtained a ruling that

form was immaterial if in substance there was corporate resemblance. There clearly was in that case:—the capital of the enterprise belonged to the group and the interest of the investors was only in the dividends when, as and if declared, not an ownership of the assets themselves.

Having procured this ruling, the Bureau proceeded in its turn to overreach the taxpayer by finding corporate resemblance on immaterial matters of form where in fundamental nature there was no resemblance whatever. In that process it dragged into the scope of its corporate tax regulations the fixed investment trust.

The Tax Court ruled that the fixed investment trust—the vehicle by which the small investor purchases an interest in underlying securities—had no essential resemblance to a corporation. The Circuits divided, as we have pointed out in our brief on petition for certiorari.

This case is the first, however, to openly declare that there need be no benficial ownership whatever of capital or income by the enterprise or group to enable it to be taxed as though it were a corporation—and, contrary to the admitted fact, as though it actually owned the securities and the income thereon. Said the Circuit Court:

> "It is true that if the trustee receives income from the underlying securities,* its receipt creates a corresponding indebtedness to the individual beneficiary and that the benficial interest of the underlying securities was in the beneficiaries." (R., p. 289.)

In other words, the Circuit Court itself says that the trust was a conduit without beneficial ownership through which the income flows from Standard Oil and the other underlying corporations to the individual beneficial owners of the securities.

To assert that such income is taxable both to the beneficial owner (which it is without question) AND to the conduit through which it flows is flatly contrary to the most fundamental principles of tax law.

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*That is the only income in this case. (Note is our own.)

And all of this is done in the name of the *Morrissey* case.

We realize that the Supreme Court is not a court of error, but we respectfully urge that where the misapprehension of the meaning of a decision of this Court has gone as far as it has in respect of the *Morrissey* case—with Circuit after Circuit arriving at a different conclusion regarding its meaning, with some supporting and some opposing the Tax Court, and with this culminating decision of the Tenth Circuit reading into it an overthrow of so fundamental a principle of tax law—when conflict and misapprehension have gone so far, we respectfully urge that it is the duty of this Court to grant certiorari.

Respectfully submitted,

THE CITY NATIONAL BANK AND TRUST COMPANY, TRUSTEE, UNDER TRUST AGREEMENT WITH HAMILTON DEPOSITORS OF HAMILTON TRUST SHARES.

By MORRISON SHAFROTH,
W. W. GRANT,
HENRY W. TOLL,

Attorneys for Petitioner.

CERTIFICATE OF COUNSEL.

We, the undersigned attorneys for the above named petitioner, do hereby certify that the foregoing petition for rehearing is presented in good faith and not for purpose of delay.

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HENRY W. TOLL,

Attorneys for Petitioner.